CHAPTER 1

What Is Financial Accounting, and Why Is It Important?

1. MAKING GOOD FINANCIAL DECISIONS ABOUT AN ORGANIZATION

1. Define "*financial accounting*."
2. Understand the connection between financial accounting and the communication of information about an organization.
3. Explain the importance of gaining an understanding of financial accounting.
4. List decisions that an individual might make about an organization.
5. Differentiate between financial accounting and managerial accounting.
6. Provide reasons for individuals to study the financial accounting information supplied by their employers.

1.1—Financial Accounting and Information [PowerPoint 1-5]

Financial accounting is the communication of information about a business or other type of organization (such as a charity or a government) so that individuals can assess its financial health and future prospects. Financial accounting provides the rules and structure for the conveyance of financial information about businesses (and other organizations) to maximize clarity and understanding.

Organization → reports information based on the principles of financial accounting → interested individuals assess financial health and future prospects

1.2—Financial Accounting and Wise Decision Making [PowerPoint 1-6]

Many possible benefits can be gained from acquiring a strong knowledge of financial accounting because it provides the accepted methods for communicating relevant information about an organization. Developing the ability to analyze financial information and then making use of that knowledge to arrive at sound decisions can be critically important.

Example: A recent college graduate looking at full-time employment opportunities might want to determine the probability that Company A will have a brighter economic future than Company B.

1.3—Common Decisions about Organizations [PowerPoint 1-7]

Many decisions deal with the organization's current financial condition and its future prospects. Having knowledge of the principles of financial accounting can help an individual make better decisions.

Examples of individuals using financial information include:

- Loan officers, who must make decisions about loaning money to companies, are concerned with the companies' ability to repay the money plus interest in the future.
- Credit analysts must decide whether to extend credit to customers. Companies need to find new customers to whom to sell their products, but they do not make money if those customers do not pay.
- Investment counselors advise clients about making investments in companies. These individuals need to understand the financial situation of the investment opportunities if they are going to help their clients make wise decisions.

1.4—Financial Accounting versus Managerial Accounting [PowerPoint 1-8]

Examples:

- Should a business buy or rent its headquarters?
- What price should a business charge for its services?
- Should a business advertise on television or the Internet?

Decisions like these are made *within* the organization, not *about* the organization.

1.4.1—Managerial Accounting [PowerPoint 1-9]

Managerial accounting refers to the communication of information within an organization so that internal decisions can be made in an appropriate manner.

1.4.2—Financial Accounting versus Managerial Accounting [PowerPoint 1-9]

Financial accounting is not better, more useful, or more important than managerial accounting. They have been created to achieve different objectives.

1.5—Financial Accounting Information and Company Employees [PowerPoint 1-10]

Every employee should be interested in studying information produced by financial accounting to judge future employment prospects.

- A business that is doing well will possibly award larger pay raises or perhaps significant end-of-year cash bonuses.
- A financially healthy organization can afford to hire new employees, buy additional equipment, or pursue major new initiatives.
- A business that is struggling might anticipate layoffs, pay cuts, or reductions in resources.

1.5.1—Teaching Tip: Value of Information [PowerPoint 1-11]

You might want to mention a quote by Kofi Annan, former secretary-general of the United Nations: "Knowledge is power. Information is liberating."

2. INCORPORATION AND THE TRADING OF CAPITAL SHARES

1. Define "incorporation."
2. Explain the popularity of investing in the capital stock of a corporation.
3. Discuss the necessity and purpose of a board of directors.
4. List the potential benefits gained from acquiring capital stock.

2.1—The Ownership Shares of an Incorporated Business [PowerPoint 1-13]

2.1.1—The Ownership Shares of an Incorporated Business [PowerPoint 1-13]

Incorporation is the process undertaken by owners of a business or other type of organization where they apply to the state government to become identified as an entity legally set apart from its owners.

A *corporation* is an organization that has been formally recognized by the state government as a separate legal entity that can act independently of its owners.

A corporation has the ability to obtain monetary resources by selling (also known as issuing) capital shares that allow investors to become owners. They are then known as stockholders or shareholders. One of the great advantages of incorporation is the ease by which most capital stock can be exchanged.

A business that has not been incorporated is either a *sole proprietorship* (one owner) or a *partnership* (more than one owner). Without the separation provided by incorporation, a clear distinction between owner and business does not exist. For example, debts incurred by a business that is a sole proprietorship or partnership may ultimately have to be satisfied by the owner personally. Thus, individuals tend to avoid making investments in unincorporated businesses unless they can be involved directly in the management. However, partnerships and sole proprietorships remain popular because they are easy to create and offer possible income tax benefits

2.1.2—Trading Shares of Stock [PowerPoint 1-14]

Often, capital stock is sold on a public exchange like the New York Stock Exchange or NASDAQ.

If traded on a stock exchange, shares of the capital stock of a corporation continually go up and down in value based on myriad factors, including the perceived financial health and future prospects of the organization.

2.1.3—Teaching Tip: Global Stock Exchanges [PowerPoint 1-14]

A good opportunity to introduce the global nature of business is to introduce students to stock exchanges around the world. Bring the focus back to the U.S. exchanges at the end as you transition into the In-Class Activity.

2.1.2—IN-CLASS ACTIVITY

Movement of Stock Prices

Description: Before class, assign two publicly traded companies to each student or allow them to choose their own. Have them find each company's high and low stock price during the past year. Potential web sites to use include http://finance.yahoo.com and http://moneycentral.msn.com. During class, break students into groups to discuss how widely their companies' stock prices have varied over the year. Have them brainstorm potential reasons for these variations.

2.1.2—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√	√	10 Minutes	Students will need to look up stock prices prior to class

2.2—The Operational Structure of a Corporation [PowerPoint 1-15]

Obviously, a great many corporations like The Coca-Cola Company have an enormous quantity of capital shares held by tens of thousands of investors. Virtually none of these owners can expect to have any impact on the daily operations of the business. In a vast number of such organizations, stockholders elect board of directors who in turn hires the members of management who run the business on a daily basis.

2.2.1—Board of Directors [PowerPoint 1-16]

The *Board of Directors* is a representative group voted to this position by stockholders to oversee the management of a corporation. The board meets periodically (often quarterly) to review operating, investing, and financing results as well as to approve strategic policy initiatives.

2.2.2—Teaching Tip: Board of Directors on NPR

If your classroom has internet and speaker capability, take a few minutes to listen to a story produced by National Public Radio on the roles played by a board of directors. It can be found at http://www.npr.org/templates/story/story.php?storyId=105576374

Running time: 4 minutes, 24 seconds

2.2.3—Company Operational Structure [PowerPoint 1-17]

The following list demonstrates the hierarchy of authority and responsibility in a typical corporation.

Ownership	Each capital share is the equivalent of one unit of ownership.
Board of Directors	Elected by shareholders to hire and oversee the management of the company and make policy decisions.
Management	Officials such as the president, the chief financial officer, and the director of marketing who are in charge of daily operations.
Employees	All individuals who work for a company who are not deemed to be members of the management.

2.3—Predicting the Appreciation of Capital Stock Values [PowerPoint 1-18]

Capital shares of thousands of corporations trade each day on markets around the world such as the New York Stock Exchange or NASDAQ (National Association of Securities Dealers Automated Quotations). One party is looking to sell shares whereas another is seeking shares to buy. Stock markets match up these buyers and sellers so that a mutually agreed-upon price can be negotiated.

Investors believe that a company is financially healthy and future prospects are good—stock price rises

Investors predict that company will not remain financially healthy—stock price drops

Factors Affecting Stock Price **[PowerPoint 1-19]**

- Perceived quality of management
- Historical trends in profitability
- Viability of company's industry
- Health of economy
- Other factors

2.3.1—Financial Accounting and the Stock Market [PowerPoint 1-20]

Investors attempt to assess the financial condition and prospects of various business organizations on an ongoing basis. Being able to understand and make use of reported financial data helps improve the investor's knowledge of corporation and, thus, the chance of making wise decisions about the buying and selling of capital shares. Ignorance often leads to poor decisions and much less lucrative outcomes.

2.3.2—Long-term Capital Gain or Loss [PowerPoint 1-21]

Gain or loss on sale of stock held for longer than one year. Significant tax savings may result over selling stock held for less than one year.

2.3.3—Teaching Tip: U.S. Tax Policy

For those with time, you may want to give a brief introduction to the U.S. Tax System. Students may question why long-term stock gains are taxed differently than short-term ones. Discussing Congress' wish to encourage investing so that businesses can get needed capital should give them an interesting connection between business and government about which they may never have thought.

2.4—The Receipt of Dividends [PowerPoint 1-22]

Many corporations pay cash **dividends** to their stockholders periodically.

Dividend: A dividend is a reward for being an owner of a business that is prospering.

- Reward for being an owner
- Distribution of income
- Not required by law
- Set by Board of Directors

2.5—Annual Rate of Return on an Investment in Capital Stock

2.5.1—Work through an example of computing annual rate of return on stock [PowerPoint 1-23, 24]

January 1, Year One, Investor buys stock in both Company A and Company B

	Company A	**Company B**
Price per share, 1/1:	$100	$100
Dividend during year:	$1.00 per share	$5.00 per share
Price per share, 12/31:	$108	$91

Value of Company A: $108 + $1 = $109
Annual Rate of Return = ($109 – $100)/$100 = **9%**

Value of Company B: $91 + $5 = $96
Annual Rate of Return = ($96 – $100)/$100 = **–4%**

2.5.2—Have students work through an example of computing annual rate of return on stock, either individually or in teams [PowerPoint 1-25, 26]

January 1, Year One, Investor buys stock in both Company S and Company T

	Company S	**Company T**
Price per share, 1/1:	$10	$10
Dividend during year:	$.50 per share	$2.00 per share
Price per share, 12/31:	$12	$7

Value of Company S: $12 + $.50 = $12.50
Annual Rate of Return = ($12.50 – $10)/$10 = **25%**

Value of Company T: $7 + $2 = $9
Annual Rate of Return = ($9 – $10)/$10 = –**10%**

2.5.3—Teaching Tip: Tie It All Together

A good way to wrap up the first two sections is to point out that a careful analysis of the available data might have helped this investor to choose Company A rather than Company B. The data is a result of financial accounting. A careful analysis of it can only result when the user has knowledge of financial accounting.

Estimating the annual rate of return is important for investors because it helps them select from among multiple investment opportunities. This computation provides a method for quantifying the financial benefit earned in the past and expected in the future.

3. USING FINANCIAL ACCOUNTING FOR WISE DECISION MAKING

1. List the predictions that investors and potential investors want to make about a business organization.
2. List the predictions that creditors and potential creditors want to make about a business organization.
3. Explain the reporting of monetary amounts as a central focus of financial accounting.
4. Explain how financial accounting information is enhanced and clarified by verbal explanations.
5. Understand the function played by the annual report published by many businesses and other organizations.

3.1—Financial Accounting Information and Investments in Capital Stock [PowerPoint 1-29]

Investors wish to estimate:

1. The future price of a corporation's capital stock
2. The future amount of cash dividends that will be paid by the business

3.2—Financial Accounting Information and Other Interested Parties [PowerPoint 1-30]

Sizeable portions of the parties that study the financial information reported by an organization are probably most interested in the likelihood that money will be available in the future to pay its debts.

What information interests creditors and potential creditors?

1. Amount of debt company already has
2. When debt is coming due
3. Perceived ability of company to meet obligations as they come due

Ultimately, creditors attempt to anticipate the organization's future cash flows to measure the risk that debt principal and interest payments might not be forthcoming when due.

3.3—The Nature of Financial Information [PowerPoint 1-31]

Financial information—data that can be measured in monetary terms

Examples:

- Company owes bank $400,000
- Company owns equipment worth $20,000
- Company made sales of $5,900,000

Not financial information:

- Company has 7,890 employees

- Company operates in 23 states

3.4—Financial Accounting and Verbal Explanations [PowerPoint 1-32]

Although financial accounting starts by reporting balances as monetary amounts, the communication process does not stop there. Extensive verbal explanations as well as additional numerical data are also provided to clarify or expand the monetary information where necessary.

Example: Company reports pending lawsuit with probable loss of $750,000. This is the communication of financial information. The company will also communicate verbal explanations, which provide the user with more information such as cause of the lawsuit and the likelihood of loss.

Steps in Providing Information [PowerPoint 1-33]
Step One: Financial information is provided in monetary terms
Step Two: Further explanation is given to clarify and expand on those monetary balances

3.5—The Annual Report [PowerPoint 1-34]

Most companies regardless of size prepare and distribute an annual report shortly after the end of each year.

CHAPTER 2
What Should Decision Makers Know in Order to Make Good Decisions about an Organization?

1. CREATING A PORTRAIT OF AN ORGANIZATION THAT CAN BE USED BY DECISION MAKERS

1. Explain the comparison of financial accounting to the painting of a portrait.
2. Understand the reasons why financial accounting information does not need to be exact.
3. Define the term "material" and describe its fundamental role in financial accounting.
4. Define the term "misstatement" and differentiate between the two types of misstatements: errors and fraud.

1.1—Financial Statements: The Portrait of an Organization
[PowerPoint 2-4]

The purpose of a portrait is to capture a likeness of the artist's model. Similarly, financial accounting attempts to present a portrait of an organization that can be used by interested parties to assess its financial health and future prospects. In accounting, this portrait is most often presented in the form of financial statements. Financial statements are a representation of an organization's operations, financial position, and cash flows.

1.2—A Likeness Does Not Have to Be Exact **[PowerPoint 2-5]**

Like a portrait, financial statements are not an exact depiction of its subject. Just as the eyes in a portrait differ from the person's actual eyes, the numbers in the financial statements are not exact. Financial accounting information is rarely an exactly accurate portrait. The accountant's goal is to create financial statements that present a likeness of an organization that can be used to make decisions.

Example: the reported cost of constructing a building may be off slightly because of the sheer volume of money being spent on the many different aspects of the project. No one expects the reported cost of a $50 million manufacturing plant to be accurate to the penny.

1.2.1—Usefulness of Financial Statements [PowerPoint 2-5]

If financial information provides a fair representation, an interested party should be able to make use of it to arrive at desired projections such as future stock prices. A potential investor or creditor does not need numbers that are absolutely accurate in order to assert, "Based on the information available in the financial statements, I understand enough about this business to make informed decisions. Even if I could obtain figures that were more accurate, I believe that I would still take the same actions."

1.2.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Before class, require students to pull the income statement and balance sheet of a company that interests them, such as Starbucks or Target. These statements can be used to illustrate many of the points of this chapter. To begin, have the students examine the magnitude of the numbers on their financial statements. Many will be in the millions, and some in the billions, of dollars. It should make sense to them immediately that those types of numbers cannot be exact to the penny.

1.2.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		2 Minutes	Students will need to bring financial statements to class

1.3—Material Misstatements [PowerPoint 2-6]

In financial accounting, the data presented to decision makers by an organization should never contain any misstatements that are deemed to be material. Financial statements must be free of material misstatements in order to be of use to decision makers.

1.3.1—Two Types of Misstatements [PowerPoint 2-7]

The two types of misstatements are *errors* and *fraud*. A misstatement is an error (made accidentally) or fraud (done intentionally) where reported figures or words actually differ from the underlying reality. In simple terms, the information is wrong.

1.3.2—Teaching tip

Before giving students examples of errors and fraud, see if they can come up with example of their own. Ask if they know of any companies or individuals, which have been accused of fraud. They should come up with examples such as Enron or Madoff. This will allow for a good discussion of the difference between an error and fraud.

1.3.3—Material Misstatement [PowerPoint 2-7]

A misstatement is deemed to be material if it is so significant that its presence would impact a decision made by an interested party. A financial accountant never claims that reported information is correct, accurate, or exact. However, the accountant must take all precautions necessary to ensure that reported data contain no material misstatements. All parties need to believe that reported information can be used with confidence because it presents a fair likeness of the organization as a whole.

1.3.3—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Would a $100 misstatement make a difference to them if they were thinking of investing in this company's stock? How about a $100 million misstatement? Call on one or two students to explain their answers.

1.3.3—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		2 Minutes	Students will need to bring financial statements to class

2. DEALING WITH UNCERTAINTY

1. Discuss the challenge created for financial accountants by the presence of uncertainty.
2. List examples of uncertainty that an accountant might face in reporting financial information about an organization.
3. Explain how financial accounting resembles a language such as Spanish or Japanese.

2.1—Uncertainty, the True Challenge for Reporting [PowerPoint 2-9]

Many of the figures reported by an organization do not lend themselves to accuracy. The primary reason that exactness is not a goal can be summed up in a single word: uncertainty.

Financial accounting is a structured attempt to paint a fairly presented portrait of an organization's overall operations, financial condition, and cash flows. This requires the reporting of many events where a final resolution might not occur for months or even years. Uncertainty keeps financial information from being precise. Examples of uncertainty faced by organizations include law suits, bonuses and warranties.

Many of the most important accounting rules have been created to establish requirements for the reporting of uncertain situations. Because of the quantity and variety of such unknowns, exactness simply cannot be an objective of financial reporting.

Whenever an organization encounters a situation of this type, the accountant must come to understand what has happened and then determine a logical method to communicate a fair representation of that information within the framework provided by financial accounting rules. Thus, reporting events in the face of uncertainty is surely one of the major challenges of being a financial accountant.

2.2—Accounting as the Language of Business [PowerPoint 2-10]

Accounting is a language—one that enables an organization to communicate a portrait of its financial health and future prospects to interested parties by using words and numbers rather than oils and watercolors.

2.2.1—An Effective Communication [PowerPoint 2-10]

An effective communication is possible in a language when: 1) set terminology exists and 2) structural rules and principles are applied.

Financial accounting has its own terminology. Many words and terms (such as "LIFO" and "accumulated depreciation") have specific meanings. In addition, a comprehensive set of rules and principles has been established over the decades to provide structure and standardization. They guide the reporting process so that the resulting information will be fairly presented and readily understood by all interested parties, both inside and outside the organization.

For successful communication of financial information, both the terminology and the structural rules must be understood by all parties involved.

2.2.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Are there terms they do not understand or recognize, much as if they were looking at foreign language? Ask one or two students to share a term they do not understand. Explain that the terminology will explained over the course of the term. They will be learning the language of business.

2.2.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		2 Minutes	Students will need to bring financial statements to class

3. THE NEED FOR ACCOUNTING STANDARDS

1. Describe the purpose of accounting standards such as U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS) and the benefits that these rules provide.
2. Explain the importance of accounting standards to the development of a capitalistic economy.
3. Understand the role played by the Financial Accounting Standards Board (FASB) in the ongoing evolution of accounting standards in the United States.
4. Discuss the advantages and the possibility that financial reporting will switch from U.S. GAAP to IFRS.

3.1—The Existence of Formal Accounting Standards [PowerPoint 2-13]

The existence of financial accounting standards is essential to ensure that all communicated information is understood properly. During the past ten years or so, as a truly global economy became a reality, two primary systems of accounting rules emerged. U.S. generally accepted accounting principles (U.S. GAAP) are applied to most financial information presented within the United States. International Financial Reporting Standards (IFRS) are now used almost exclusively in the rest of the world.

Having two bodies of rules causes problems for decision makers. Not surprisingly, many corporate officials and decision makers would prefer to see one universal set of accounting standards. Over the past few years, extensive progress has been made in bringing these two sets of standards into alignment. However, a number of significant differences continue to exist.

3.1.1—How does GAAP keep pace with a changing business world?

Some rules are older, but many have been developed in the last 20 to 30 years. Accounting principles evolve as the business world changes. Significant changes are made to GAAP every year.

3.2—The Development of Accounting Standards [PowerPoint 2-14]

The Financial Accounting Standards Board (FASB) has held the authority to develop U.S. GAAP since 1973. IFRS are produced by the London-based International Accounting Standards Board (IASB). Whether U.S. GAAP or IFRS, accounting standards evolve quite quickly as the nature of business changes and new reporting issues, problems, and resolutions arise.

Because standardization exists in most areas of the reporting process, any decision maker with an adequate knowledge of financial accounting—whether located in Phoenix, Arizona or in Portland, Maine—should be able to understand fairly presented information being conveyed by a wide variety of organizations. They all speak the same language. Put simply, the existence of accounting standards enables organizations and other interested parties to communicate successfully.

3.2.1—Teaching Tip: Value of GAAP [PowerPoint 2-15]

Have a few students volunteer what they consider the greatest intellectual achievement of the 20th century. Then present this quote from the Wall Street Journal about the importance of GAAP: "*When the intellectual achievements of the 20th century are tallied, GAAP should be on everyone's Top 10 list.*"

3.3—The Importance of Accounting Standards [PowerPoint 2-15, 16]

3.3.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Pair students and ask them to compare their two companies. Tell them that each company is allowed to do their accounting however they wish, that no actual rules exist. Ask what comparisons they can make. They should say none. Now say that in truth, the accounting for these statements is governed by U.S. GAAP, and that while some judgment is allowed, the companies follow the same basic rules for accounting. Now can they make any comparisons? This should demonstrate the value of GAAP.

3.3.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√	√	3 Minutes	Students will need to bring financial statements to class

The United States has a capitalistic economy, which means that businesses are (for the most part) owned by private citizens and groups rather than by the government. To operate and grow, these companies must convince investors and creditors to contribute huge amounts of their own money voluntarily. Not surprisingly, such financing is only forthcoming if the possible risks and rewards can be assessed and then evaluated with sufficient reliability.

Bring back In-Class Activity 3.3.1 by asking them if they would be more comfortable investing their money in their company knowing that the company must follow certain accounting rules.

Before handing over thousands or even millions of dollars, decision makers must believe that they are using reliable data to make reasonable estimations of future stock prices, cash dividends, and cash flows. Otherwise, buying stocks and granting credit is no more than gambling. U.S. GAAP enables outside parties to obtain the financial information they need to reduce their perceived risk to acceptable levels. Thus, money can be raised, and businesses can grow and prosper.

If accounting standards did not exist, the development and expansion of thousands of the businesses that have become a central part of today's society might be limited or impossible simply because of the lack of available resources. An expanding economy requires capital investment. That funding is more likely to be available when financial information can be understood because it is stated in a common language: U.S. GAAP.

3.4—The Evolution of Accounting Standards [PowerPoint 2-17]

As indicated earlier, since 1973, FASB has served as the primary authoritative body in charge of producing U.S. GAAP for nongovernmental entities such as businesses and private not-for-profit organizations. FASB is an independent group supported by the U.S. government, various accounting organizations, and many private businesses.

Typically, accounting problems arise over time within the various areas of financial reporting. New types of financial events can be created, for example, that are not covered by U.S. GAAP or, perhaps, weaknesses in earlier rules start to become evident. If such concerns grow to be serious, FASB steps in to study the issues and alternatives. After a period of study, the board might pass new rules or make amendments to previous ones.

The FASB and other standard setting bodies will be covered in more detail in Chapter 6.

4. FOUR BASIC TERMS FOUND IN FINANCIAL ACCOUNTING

1. Define "asset" and provide examples found in financial reporting.
2. Define "liability" and provide examples found in financial reporting.
3. Define "revenue" and provide examples found in financial reporting.
4. Define "expense" and provide examples found in financial reporting.

4.1—Assets, Liabilities, Revenues, and Expenses [PowerPoint 2-19, 20]

Begin with basic terminology. Four fundamental terms will be introduced in this chapter - asset, liability, revenue, and expense. Knowledge of these words is essential in gaining an understanding of accounting because they serve as the foundation for a significant portion of the financial information provided by any organization.

4.2—Definition of the Term "Asset" [PowerPoint 2-19]

An asset is a probable future economic benefit that an organization either owns or controls. Every business has its own particular mix of assets. Virtually all have cash and accounts receivable (money due from customers). Many also have inventory (merchandise held for resale). The size and type of other assets will vary significantly based on the company and the industry in which it operates.

4.2.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Point out the left-hand side or top of the balance sheet. Ask volunteers to read off assets listed there. Ask students to determine how that item can be used to benefit the business in the future. For example, if a student names "inventory," its benefit could be that it can be sold for cash.

4.2.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		3 Minutes	Students will need to bring financial statements to class

4.3—Definition of the Term “Liability” [PowerPoint 2-19]

A more formal definition of a liability is that it is a probable future sacrifice of economic benefits arising from present obligations but, for simplicity sake, liabilities can be viewed as the debts of the organization.

Another term that is often encountered in financial reporting is “net assets.” The net asset total for an organization is simply its assets (future benefits) less its liabilities (debts). This balance is also known as “equity” in reference to the owners’ rights to all assets in excess of the amount owed on liabilities. A business’s net assets will increase if assets go up or if liabilities decrease. Changes in net assets show growth (or shrinkage) in the size of the organization over time.

4.3.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Point out the right-hand side or middle of the balance sheet. Ask volunteers to read off liabilities listed there. Ask students if it makes sense that that item is seen as a debt of the organization. For example, if a student names “accounts payable,” this makes sense because these are amounts owed to suppliers.

4.3.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		3 Minutes	Students will need to bring financial statements to class

4.4—Definition of the Term "Revenue" [PowerPoint 2-20]

The term "revenue" is a measure of the financial impact on an organization that results from a particular process. This process is a sale.

For timing purposes, revenue is recognized when the earning process takes place. That is normally when the goods or services are delivered.

4.4.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Point out the income statement. Point out that the top line is revenue.

4.4.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		1 Minute	Students will need to bring financial statements to class

4.5—Definition of the Term "Expense" [PowerPoint 2-20]

An expense is an outflow or reduction in net assets that was incurred by an organization in hopes of generating revenues.

In some ways, expenses are the opposite of revenues that measure the inflows or increases in net assets that are created by sales. Expense figures reflect outflows or decreases in net assets incurred in hopes of generating revenues.

4.5.1—IN-CLASS ACTIVITY

Using Actual Financial Statements

Description: Ask the students to look at their financial statements (see 1.2.1 above). Point out the income statement. Ask volunteers to read off some of the expenses listed. Many of these will not be familiar to students, i.e., cost of goods sold and depreciation. Inform them that they will be learning the meanings of all of these terms as they learn the "language of accounting."

4.5.1—Appropriate In-Class Use

Pages	Discussion	Team Activity	Class Time	Assign Ahead
	√		1 Minute	Students will need to bring financial statements to class